

GRAINGER W W INC
Form 10-Q
October 31, 2013

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

(Mark One)

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF
THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended September 30, 2013
OR

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF
THE SECURITIES EXCHANGE ACT OF 1934

For the transition period from _____ to _____

Commission file number 1-5684

W.W. Grainger, Inc.
(Exact name of registrant as specified in its charter)

Illinois 36-1150280
(State or other jurisdiction of incorporation or organization) (I.R.S. Employer Identification No.)

100 Grainger Parkway, Lake Forest, Illinois 60045-5201
(Address of principal executive offices) (Zip Code)
(847) 535-1000
(Registrant's telephone number including area code)

Not Applicable
(Former name, former address and former fiscal year; if changed since last report)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes No

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Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of “large accelerated filer,” “accelerated filer” and “smaller reporting company” in Rule 12b-2 of the Exchange Act.

Large accelerated filer Accelerated filer Non-accelerated filer Smaller reporting company

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).
Yes No

There were 69,411,710 shares of the Company’s Common Stock outstanding as of September 30, 2013.

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PART I – FINANCIAL INFORMATION

Item 1. Financial Statements

W.W. Grainger, Inc. and Subsidiaries

CONDENSED CONSOLIDATED STATEMENTS OF EARNINGS

(In thousands of dollars, except for share and per share amounts)

(Unaudited)

| | Three Months Ended | | Nine Months Ended | |
|--|--------------------|-------------|-------------------|-------------|
| | September 30, | | September 30, | |
| | 2013 | 2012 | 2013 | 2012 |
| Net sales | \$2,398,530 | \$2,281,205 | \$7,060,526 | \$6,723,925 |
| Cost of merchandise sold | 1,347,164 | 1,287,245 | 3,930,440 | 3,777,290 |
| Gross profit | 1,051,366 | 993,960 | 3,130,086 | 2,946,635 |
| Warehousing, marketing and administrative expenses | 704,651 | 739,634 | 2,089,995 | 2,073,948 |
| Operating earnings | 346,715 | 254,326 | 1,040,091 | 872,687 |
| Other income and (expense): | | | | |
| Interest income | 822 | 707 | 2,516 | 1,904 |
| Interest expense | (3,734) | (4,751) | (10,102) | (10,718) |
| Other non-operating income | 381 | 830 | 2,527 | 1,698 |
| Other non-operating expense | (323) | (392) | (1,728) | (1,609) |
| Total other income and (expense) | (2,854) | (3,606) | (6,787) | (8,725) |
| Earnings before income taxes | 343,861 | 250,720 | 1,033,304 | 863,962 |
| Income taxes | 130,786 | 92,916 | 384,948 | 323,599 |
| Net earnings | 213,075 | 157,804 | 648,356 | 540,363 |
| Less: Net earnings attributable to noncontrolling interest | 2,286 | 2,410 | 8,069 | 6,749 |
| Net earnings attributable to W.W. Grainger, Inc. | \$210,789 | \$155,394 | \$640,287 | \$533,614 |
| Earnings per share: | | | | |
| Basic | \$2.99 | \$2.19 | \$9.06 | \$7.50 |
| Diluted | \$2.95 | \$2.15 | \$8.92 | \$7.35 |
| Weighted average number of shares outstanding: | | | | |
| Basic | 69,461,060 | 69,625,081 | 69,562,192 | 69,896,864 |
| Diluted | 70,547,071 | 70,960,547 | 70,706,688 | 71,306,416 |
| Cash dividends paid per share | \$0.93 | \$0.80 | \$2.66 | \$2.26 |

The accompanying notes are an integral part of these financial statements.

W.W. Grainger, Inc. and Subsidiaries

CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE EARNINGS

(In thousands of dollars)

(Unaudited)

| | Three Months Ended | | Nine Months Ended | |
|---|--------------------|-----------|-------------------|-----------|
| | September 30, | | September 30, | |
| | 2013 | 2012 | 2013 | 2012 |
| Net earnings | \$213,075 | \$157,804 | \$648,356 | \$540,363 |
| Other comprehensive earnings (losses): | | | | |
| Foreign currency translation adjustments, net of tax (expense) benefit of \$(1,191), \$(2,029), \$2,326 and \$(2,195), respectively | 21,559 | 29,168 | (48,241) | 24,698 |
| Derivative instruments, net of tax benefit (expense) of \$1,289, \$1,889, \$(1,705) and \$1,673, respectively | (2,198) | (3,727) | 3,836 | (4,983) |
| Other, net of tax benefit of \$361, \$0, \$1,083 and \$0, respectively | (765) | 120 | (1,292) | 628 |
| Comprehensive earnings, net of tax | 231,671 | 183,365 | 602,659 | 560,706 |
| Comprehensive earnings (losses) attributable to noncontrolling interest | 2,995 | 1,421 | (2,304) | 6,622 |
| Comprehensive earnings attributable to W.W. Grainger, Inc. | \$228,676 | \$181,944 | \$604,963 | \$554,084 |

The accompanying notes are an integral part of these financial statements.

W.W. Grainger, Inc. and Subsidiaries
 CONDENSED CONSOLIDATED BALANCE SHEETS
 (In thousands of dollars, except for share and per share amounts)

| | (Unaudited) Sep 30, 2013 | Dec 31, 2012 |
|--|-----------------------------|--------------------|
| ASSETS | | |
| CURRENT ASSETS | | |
| Cash and cash equivalents | \$539,995 | \$452,063 |
| Accounts receivable (less allowances for doubtful accounts of \$19,010 and \$19,449, respectively) | 1,082,108 | 940,020 |
| Inventories – net | 1,256,852 | 1,301,935 |
| Prepaid expenses and other assets | 106,992 | 110,414 |
| Deferred income taxes | 59,631 | 55,967 |
| Prepaid income taxes | 3,519 | 40,241 |
| Total current assets | 3,049,097 | 2,900,640 |
| PROPERTY, BUILDINGS AND EQUIPMENT | 2,839,974 | 2,760,434 |
| Less: Accumulated depreciation and amortization | 1,703,658 | 1,615,861 |
| Property, buildings and equipment – net | 1,136,316 | 1,144,573 |
| DEFERRED INCOME TAXES | 58,054 | 51,536 |
| GOODWILL | 568,954 | 543,670 |
| OTHER ASSETS AND INTANGIBLES – NET | 439,128 | 374,179 |
| TOTAL ASSETS | \$5,251,549 | \$5,014,598 |

W.W. Grainger, Inc. and Subsidiaries
 CONDENSED CONSOLIDATED BALANCE SHEETS (Continued)
 (In thousands of dollars, except for share and per share amounts)

| | (Unaudited) Sep 30, 2013 | Dec 31, 2012 |
|--|-----------------------------|--------------------|
| LIABILITIES AND SHAREHOLDERS' EQUITY | | |
| CURRENT LIABILITIES | | |
| Short-term debt | \$73,023 | \$79,071 |
| Current maturities of long-term debt | 27,501 | 18,525 |
| Trade accounts payable | 435,165 | 428,782 |
| Accrued compensation and benefits | 179,202 | 165,450 |
| Accrued contributions to employees' profit sharing plans | 134,636 | 170,434 |
| Accrued expenses | 206,927 | 204,800 |
| Income taxes payable | 18,038 | 12,941 |
| Total current liabilities | 1,074,492 | 1,080,003 |
| LONG-TERM DEBT (less current maturities) | 448,127 | 467,048 |
| DEFERRED INCOME TAXES AND TAX UNCERTAINTIES | 120,703 | 119,280 |
| EMPLOYMENT-RELATED AND OTHER NON-CURRENT LIABILITIES | 239,088 | 230,901 |
| SHAREHOLDERS' EQUITY | | |
| Cumulative Preferred Stock – \$5 par value – 12,000,000 shares authorized; none issued nor outstanding | — | — |
| Common Stock – \$0.50 par value – 300,000,000 shares authorized; issued 109,659,219 shares | 54,830 | 54,830 |
| Additional contributed capital | 876,924 | 812,573 |
| Retained earnings | 5,731,002 | 5,278,577 |
| Accumulated other comprehensive earnings | 18,254 | 53,578 |
| Treasury stock, at cost – 40,247,509 and 40,180,724 shares, respectively | (3,392,438 |) (3,175,646 |
| Total W.W. Grainger, Inc. shareholders' equity | 3,288,572 | 3,023,912 |
| Noncontrolling interest | 80,567 | 93,454 |
| Total shareholders' equity | 3,369,139 | 3,117,366 |
| TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY | \$5,251,549 | \$5,014,598 |

The accompanying notes are an integral part of these financial statements.

W.W. Grainger, Inc. and Subsidiaries
 CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
 (In thousands of dollars)
 (Unaudited)

| | Nine Months Ended September 30, | |
|--|------------------------------------|---------------|
| | 2013 | 2012 |
| CASH FLOWS FROM OPERATING ACTIVITIES: | | |
| Net earnings | \$648,356 | \$540,363 |
| Provision for losses on accounts receivable | 5,775 | 6,604 |
| Deferred income taxes and tax uncertainties | (8,683 |) (6,315) |
| Depreciation and amortization | 126,164 | 113,338 |
| Stock-based compensation | 44,028 | 42,815 |
| Change in operating assets and liabilities – net of business acquisitions: | | |
| Accounts receivable | (130,068 |) (131,057) |
| Inventories | 44,957 | 12,116 |
| Prepaid expenses and other assets | 40,290 | 46,648 |
| Trade accounts payable | 1,727 | (39,657) |
| Other current liabilities | (46,521 |) (3,861) |
| Current income taxes payable | 6,243 | (12,890) |
| Employment-related and other non-current liabilities | 13,955 | 11,478 |
| Other – net | (5,795 |) (3,473) |
| Net cash provided by operating activities | 740,428 | 576,109 |
| CASH FLOWS FROM INVESTING ACTIVITIES: | | |
| Additions to property, buildings and equipment | (148,361 |) (155,163) |
| Proceeds from sales of property, buildings and equipment | 3,654 | 5,035 |
| Net cash paid for business acquisitions | (127,960 |) (24,384) |
| Other – net | (160 |) 440 |
| Net cash used in investing activities | (272,827 |) (174,072) |
| CASH FLOWS FROM FINANCING ACTIVITIES: | | |
| Borrowings under lines of credit | 122,297 | 93,506 |
| Payments against lines of credit | (128,157 |) (137,616) |
| Proceeds from issuance of long-term debt | — | 300,000 |
| Payments of long-term debt and commercial paper | (14,157 |) (218,350) |
| Proceeds from stock options exercised | 66,512 | 54,266 |
| Excess tax benefits from stock-based compensation | 53,319 | 44,177 |
| Purchase of treasury stock | (279,619 |) (296,458) |
| Cash dividends paid | (188,688 |) (161,998) |
| Net cash used in financing activities | (368,493 |) (322,473) |
| Exchange rate effect on cash and cash equivalents | (11,176 |) 5,748 |
| NET CHANGE IN CASH AND CASH EQUIVALENTS | 87,932 | 85,312 |
| Cash and cash equivalents at beginning of year | 452,063 | 335,491 |
| Cash and cash equivalents at end of period | \$539,995 | \$420,803 |

The accompanying notes are an integral part of these financial statements.

W.W. Grainger, Inc. and Subsidiaries

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

1. BACKGROUND AND BASIS OF PRESENTATION

W.W. Grainger, Inc. is a broad-line distributor of maintenance, repair and operating supplies, and other related products and services used by businesses and institutions. W.W. Grainger, Inc.'s operations are primarily in the United States and Canada, with a presence in Europe, Asia and Latin America. In this report, the words "Company" or "Grainger" mean W.W. Grainger, Inc. and its subsidiaries.

The Condensed Consolidated Financial Statements of the Company and the related notes are unaudited and should be read in conjunction with the consolidated financial statements and related notes for the year ended December 31, 2012 included in the Company's Annual Report on Form 10-K filed with the Securities and Exchange Commission (SEC).

The Condensed Consolidated Balance Sheet as of December 31, 2012 has been derived from the audited consolidated financial statements at that date, but does not include all of the disclosures required by accounting principles generally accepted in the United States of America for complete financial statements.

The unaudited financial information reflects all adjustments (primarily consisting of normal recurring adjustments) which, in the opinion of management, are necessary for a fair presentation of the statements contained herein.

2. NEW ACCOUNTING STANDARDS

In February 2013, the Financial Accounting Standards Board issued Accounting Standards Update (ASU) 2013-02, Reporting of Amounts Reclassified Out of Accumulated Other Comprehensive Income. Under ASU 2013-02, an entity is required to provide information about the amounts reclassified out of accumulated other comprehensive income (AOCI) by component. In addition, an entity is required to present, either on the face of the financial statements or in the notes, significant amounts reclassified out of AOCI by the respective line items of net income, but only if the amount reclassified is required to be reclassified in its entirety in the same reporting period. For amounts that are not required to be reclassified in their entirety to net income, an entity is required to cross-reference to other disclosures that provide details about those amounts. ASU 2013-02 does not change the current requirements for reporting net income or other comprehensive income in the financial statements. ASU 2013-02 is effective for interim and annual periods beginning after December 15, 2012 and early adoption is permitted. The Company adopted ASU 2013-02 in the first quarter of 2013. The adoption of ASU 2013-02 did not have a material impact on the consolidated financial statements.

3. DIVIDEND

On October 30, 2013, the Company's Board of Directors declared a quarterly dividend of 93 cents per share, payable December 1, 2013, to shareholders of record on November 11, 2013.

4. ACQUISITION

On August 23, 2013, the Company acquired E&R Industrial Sales, Inc. (E&R Industrial). With 2012 sales of approximately \$180 million, E&R Industrial is a distributor of metalworking, production supplies and MRO materials to manufacturers and industrial customers across the Midwest and Eastern United States. The purchase price allocation has not been finalized and is subject to change as the Company obtains additional information during the measurement period related to the valuation of the acquired assets and liabilities. Due to the immaterial nature of this

transaction, disclosure of pro forma results were not considered necessary. E&R Industrial's operating results will be included beginning with the fourth quarter of 2013 due to the timing of the acquisition. E&R Industrial's results were immaterial to the Company for the third quarter of 2013.

5. SHORT-TERM DEBT

On August 22, 2013, the Company replaced an existing \$400 million line of credit with a new \$600 million line of credit to be used for general corporate purposes. The terms of the new line of credit are substantially the same as the previous line and do not contain any financial performance covenants. There were no borrowings under this new line of credit or the previous line of credit.

W.W. Grainger, Inc. and Subsidiaries

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

6. DERIVATIVE INSTRUMENTS

The fair values of the significant derivative instruments for the Company were as follows (in thousands of dollars):

| Derivatives Designated as Hedges | Sep 30, 2013 | Dec 31, 2012 |
|----------------------------------|--------------|--------------|
| Interest rate swap | \$3,018 | \$4,120 |
| Foreign currency forwards | \$3,477 | \$7,916 |

The Company uses derivative instruments to manage a portion of exposures to fluctuations in interest rates and foreign currency exchange rates. The Company does not enter into derivative financial instruments for trading or speculative purposes. The fair values of these significant derivative instruments are included in Employment-related and other non-current liabilities on the balance sheet.

The fair values of these instruments are determined by using quoted market forward rates (level 2 inputs) and reflect the present value of the amount that the Company would pay for contracts involving the same notional amounts and maturity dates. These instruments qualify for hedge accounting and the changes in fair value are reported as a component of other comprehensive earnings (losses) net of tax effects.

7. EMPLOYEE BENEFITS - POSTRETIREMENT

The Company has a postretirement healthcare benefits plan that provides coverage for a majority of its United States employees and their dependents should they elect to maintain such coverage upon retirement. Covered employees become eligible for participation when they qualify for retirement while working for the Company. Participation in the plan is voluntary and requires participants to make contributions toward the cost of the plan, as determined by the Company.

The net periodic benefit costs charged to operating expenses, which are valued at the measurement date of January 1 and recognized evenly throughout the year, consisted of the following components (in thousands of dollars):

| | Three Months Ended September | | Nine Months Ended September | |
|---------------------------------------|------------------------------|-----------|-----------------------------|-----------|
| | 30, 2013 | 2012 | 30, 2013 | 2012 |
| Service cost | \$2,647 | \$5,014 | \$7,941 | \$15,043 |
| Interest cost | 2,234 | 3,203 | 6,703 | 9,608 |
| Expected return on assets | (1,769) |) (1,553) |) (5,307) |) (4,659) |
| Amortization of transition asset | (36) |) (36) |) (107) |) (107) |
| Amortization of unrecognized losses | 931 | 1,207 | 2,793 | 3,621 |
| Amortization of prior service credits | (1,853) |) (123) |) (5,558) |) (371) |
| Net periodic benefit costs | \$2,154 | \$7,712 | \$6,465 | \$23,135 |

For the nine months of 2013, the net periodic benefit costs decreased \$17 million driven primarily by plan design changes that went into effect on January 1, 2013. Covered employees as of December 31, 2012, will remain eligible for retiree health benefits with the employee contribution structure modified for certain employees based on minimum age and service requirements. Employees hired after January 1, 2013, will not be eligible for retiree health benefits.

The Company has established a Group Benefit Trust to fund the plan and process benefit payments. The funding of the trust is an estimated amount which is intended to allow the maximum deductible contribution under the Internal Revenue Code of 1986 (IRC), as amended. There are no minimum funding requirements and the Company intends to follow its practice of funding the maximum deductible contribution under the IRC. During the three and nine months ended September 30, 2013, the Company contributed \$1.4 million and \$3.6 million, respectively, to the trust.

W.W. Grainger, Inc. and Subsidiaries

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

8. SEGMENT INFORMATION

The Company has two reportable segments: the United States and Canada. The United States operating segment reflects the results of the Company's U.S. business. The Canada operating segment reflects the results for Acklands – Grainger Inc., the Company's Canadian business. Other businesses include operations in Europe, Asia, Latin America and other U.S. operations. These other businesses individually do not meet the definition of a reportable segment. Operating segments generate revenue almost exclusively through the distribution of maintenance, repair and operating supplies, as service revenues account for less than 1% of total revenues for each operating segment. Following is a summary of segment results (in thousands of dollars):

| | Three Months Ended September 30, 2013 | | | |
|---------------------------------|---------------------------------------|------------|---------------------|--------------|
| | United States | Canada | Other Businesses | Total |
| Total net sales | \$ 1,904,552 | \$ 270,660 | \$ 258,442 | \$ 2,433,654 |
| Intersegment net sales | (34,801 |) (35 |) (288 |) (35,124 |
| Net sales to external customers | \$ 1,869,751 | \$ 270,625 | \$ 258,154 | \$ 2,398,530 |
| Segment operating earnings | \$ 342,420 | \$ 31,798 | \$ 6,182 | \$ 380,400 |
| | Three Months Ended September 30, 2012 | | | |
| | United States | Canada | Other Businesses | Total |
| Total net sales | \$ 1,776,749 | \$ 272,943 | \$ 254,817 | \$ 2,304,509 |
| Intersegment net sales | (23,049 |) (55 |) (200 |) (23,304 |
| Net sales to external customers | \$ 1,753,700 | \$ 272,888 | \$ 254,617 | \$ 2,281,205 |
| Segment operating earnings | \$ 247,054 | \$ 34,247 | \$ 8,778 | \$ 290,079 |
| | Nine Months Ended September 30, 2013 | | | |
| | United States | Canada | Other Businesses | Total |
| Total net sales | \$ 5,542,202 | \$ 842,446 | \$ 767,598 | \$ 7,152,246 |
| Intersegment net sales | (90,825 |) (186 |) (709 |) (91,720 |
| Net sales to external customers | \$ 5,451,377 | \$ 842,260 | \$ 766,889 | \$ 7,060,526 |
| Segment operating earnings | \$ 1,012,192 | \$ 101,953 | \$ 27,232 | \$ 1,141,377 |
| | Nine Months Ended September 30, 2012 | | | |
| | United States | Canada | Other Businesses | Total |
| Total net sales | \$ 5,219,559 | \$ 825,443 | \$ 742,904 | \$ 6,787,906 |
| Intersegment net sales | (63,178 |) (261 |) (542 |) (63,981 |
| Net sales to external customers | \$ 5,156,381 | \$ 825,182 | \$ 742,362 | \$ 6,723,925 |
| Segment operating earnings | \$ 856,701 | \$ 97,502 | \$ 30,737 | \$ 984,940 |
| | United States | Canada | Other Businesses | Total |
| Segment assets: | | | | |
| September 30, 2013 | \$ 1,990,795 | \$ 373,392 | \$ 366,131 | \$ 2,730,318 |
| December 31, 2012 | \$ 1,884,102 | \$ 387,915 | \$ 347,905 | \$ 2,619,922 |

W.W. Grainger, Inc. and Subsidiaries

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

Following are reconciliations of segment information with the consolidated totals per the financial statements (in thousands of dollars):

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|---|-------------------------------------|------------|------------------------------------|--------------|
| | 2013 | 2012 | 2013 | 2012 |
| Operating earnings: | | | | |
| Total operating earnings for operating segments | \$ 380,400 | \$ 290,079 | \$ 1,141,377 | \$ 984,940 |
| Unallocated expenses and eliminations | (33,685 |) (35,753 |) (101,286 |) (112,253 |
| Total consolidated operating earnings | \$ 346,715 | \$ 254,326 | \$ 1,040,091 | \$ 872,687 |
| | | | Sep 30, 2013 | Dec 31, 2012 |
| Assets: | | | | |
| Total assets for operating segments | | | \$ 2,730,318 | \$ 2,619,922 |
| Other current and non-current assets | | | 2,053,631 | 1,967,480 |
| Unallocated assets | | | 467,600 | 427,196 |
| Total consolidated assets | | | \$ 5,251,549 | \$ 5,014,598 |

Assets for operating segments include net accounts receivable and first-in, first-out inventory which are reported to the Company's Chief Operating Decision Maker.

Unallocated expenses and unallocated assets primarily relate to the Company headquarter's support services, which are not part of any business segment, as well as intercompany eliminations. Unallocated expenses include payroll and benefits, depreciation and other costs associated with headquarters-related support services. Unallocated assets include non-operating cash and cash equivalents, certain prepaid expenses and property, buildings and equipment-net.

W.W. Grainger, Inc. and Subsidiaries

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

9. EARNINGS PER SHARE

The following table sets forth the computation of basic and diluted earnings per share under the two-class method (in thousands of dollars, except for share and per share amounts):

| | Three Months Ended | | Nine Months Ended | |
|--|--------------------|------------|-------------------|------------|
| | September 30, | | September 30, | |
| | 2013 | 2012 | 2013 | 2012 |
| Net earnings attributable to W.W. Grainger, Inc. as reported | \$210,789 | \$155,394 | \$640,287 | \$533,614 |
| Distributed earnings available to participating securities | (887) | (988) | (2,605) | (2,694) |
| Undistributed earnings available to participating securities | (2,114) | (1,793) | (7,109) | (6,920) |
| Numerator for basic earnings per share – Undistributed and distributed earnings available to common shareholders | 207,788 | 152,613 | 630,573 | 524,000 |
| Undistributed earnings allocated to participating securities | 2,114 | 1,793 | 7,109 | 6,920 |
| Undistributed earnings reallocated to participating securities | (2,082) | (1,760) | (6,996) | (6,786) |
| Numerator for diluted earnings per share – Undistributed and distributed earnings available to common shareholders | \$207,820 | \$152,646 | \$630,686 | \$524,134 |
| Denominator for basic earnings per share – weighted average shares | 69,461,060 | 69,625,081 | 69,562,192 | 69,896,864 |
| Effect of dilutive securities | 1,086,011 | 1,335,466 | 1,144,496 | 1,409,552 |
| Denominator for diluted earnings per share – weighted average shares adjusted for dilutive securities | 70,547,071 | 70,960,547 | 70,706,688 | 71,306,416 |
| Earnings per share two-class method | | | | |
| Basic | \$2.99 | \$2.19 | \$9.06 | \$7.50 |
| Diluted | \$2.95 | \$2.15 | \$8.92 | \$7.35 |

10. CONTINGENCIES AND LEGAL MATTERS

From time to time the Company is involved in various legal and administrative proceedings that are incidental to its business, including claims relating to product liability, premises liability, general negligence, environmental issues, employment, intellectual property and other matters. As a government contractor selling to federal, state and local governmental entities, the Company is also subject to governmental or regulatory inquiries or audits or other proceedings, including those related to pricing compliance. It is not expected that the ultimate resolution of any of these matters will have, either individually or in the aggregate, a material adverse effect on the Company's consolidated financial position or results of operations.

W.W. Grainger, Inc. and Subsidiaries

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

General

Grainger is a broad-line distributor of maintenance, repair and operating supplies, and other related products and services used by businesses and institutions. Grainger's operations are primarily in the United States and Canada, with a presence in Europe, Asia and Latin America. Grainger uses a multichannel business model to provide customers with a range of options for finding and purchasing products utilizing sales representatives, catalogs and direct marketing materials and eCommerce. Grainger serves approximately 2 million customers worldwide through a network of highly integrated branches, distribution centers, multiple websites and export services.

Business Environment

Given Grainger's large number of customers and the diverse industries it serves, several economic factors and industry trends tend to shape Grainger's business environment. The overall economy and leading economic indicators provide general insight into projecting Grainger's growth. Grainger's sales in the United States and Canada tend to positively correlate with Gross Domestic Product (GDP), Industrial Production, Exports and Business Investment. In the United States, sales also tend to positively correlate with Business Inventory. The table below provides these estimated indicators for 2013:

| | 2013 Forecasted Growth | |
|-----------------------|------------------------|--------|
| | United States | Canada |
| GDP | 1.5% | 1.6% |
| Industrial Production | 2.4% | 1.3% |
| Exports | 2.4% | 4.3% |
| Business Investment | 3.5% | 1.8% |
| Business Inventory | 2.7% | — |

Source: Global Insight (October 2013)

According to the Federal Reserve, overall industrial production increased 3.2% from September 2012 to September 2013. This improvement positively affected Grainger's sales growth for the nine months of 2013. In addition, the light and heavy manufacturing customer end-markets have historically correlated with manufacturing employment levels and manufacturing output. The United States Department of Labor reported an increase of 0.3% in manufacturing employment levels from September 2012 to September 2013. According to the Federal Reserve, manufacturing output increased 2.6% from September 2012 to September 2013. Grainger's heavy and light manufacturing customer end-markets outperformed these indicators as sales to these customer end-markets increased in the mid-single digits and high single digits, respectively, for the nine months of 2013.

As oil production represents a large segment of the Canadian economy, fluctuations in crude oil prices can have a significant impact on the sales and business conditions in Grainger's Canadian business. According to Bloomberg, crude oil prices have increased from \$95 to \$106 per barrel, or a 12% increase from September 2012 to September 2013.

Outlook

On October 16, 2013, Grainger narrowed the 2013 sales growth guidance from a range of 5 to 8 percent to a range of 5 to 6 percent and also narrowed the 2013 earnings per share guidance from a range of \$11.40 to \$12.00 to a range of \$11.45 to \$11.65. These revised estimates reflect performance in the first nine months of the year, including ongoing growth and infrastructure investments, a softer global economy and unfavorable foreign exchange.

W.W. Grainger, Inc. and Subsidiaries

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL
CONDITION AND RESULTS OF OPERATIONS

Matters Affecting Comparability

There were 64 and 63 sales days in the third quarter of 2013 and 2012, respectively. Grainger completed several acquisitions throughout 2012 and 2013, all of which were immaterial individually and in the aggregate. Grainger's operating results have typically included the results of each business acquired since the respective acquisition dates, however, E&R Industrial's operating results will not be included until the fourth quarter of 2013 due to the timing of the acquisition.

Results of Operations – Three Months Ended September 30, 2013

The following table is included as an aid to understanding the changes in Grainger's Condensed Consolidated Statements of Earnings:

| | Three Months Ended September 30, | | Percent | |
|--|----------------------------------|---------|---------------------|---|
| | As a Percent of Net Sales | | Increase/(Decrease) | |
| | 2013 | 2012 | | |
| Net sales | 100.0 | % 100.0 | % 5.1 | % |
| Cost of merchandise sold | 56.2 | 56.4 | 4.7 | |
| Gross profit | 43.8 | 43.6 | 5.8 | |
| Operating expenses | 29.3 | 32.4 | (4.7 |) |
| Operating earnings | 14.5 | 11.2 | 36.3 | |
| Other income (expense) | (0.1 |) (0.2 |) (20.9 |) |
| Income taxes | 5.5 | 4.1 | 40.8 | |
| Noncontrolling interest | 0.1 | 0.1 | (5.1 |) |
| Net earnings attributable to W.W. Grainger, Inc. | 8.8 | % 6.8 | % 35.6 | % |

Grainger's net sales of \$2,399 million for the third quarter of 2013 increased 5% compared with sales of \$2,281 million for the comparable 2012 quarter. On a daily basis, sales increased 4%. The 4% daily increase for the quarter consisted of the following:

| | Percent Increase/(Decrease) |
|-----------------------|--------------------------------|
| Volume | 4 |
| Business acquisitions | 1 |
| Foreign exchange | (1) |
| Total | 4% |

Sales to all customer end markets, except resellers, increased in the third quarter of 2013. The increase in net sales was led by growth in sales to light manufacturing, natural resources and heavy manufacturing customers. Refer to the Segment Analysis below for further details.

Gross profit of \$1,051 million for the third quarter of 2013 increased 6%. The gross profit margin during the third quarter of 2013 increased 0.2 percentage point when compared to the same period in 2012, primarily driven by cost savings from freight consolidation and higher supplier rebates, partially offset by unfavorable customer mix from stronger sales to large customers, which carry lower margins.

Operating expenses of \$705 million for the third quarter of 2013 decreased 5%. Operating expenses in the third quarter of 2012 included \$76 million of reserves related to the resolution of government contract issues. Excluding these expenses, operating expenses increased 6% primarily driven by payroll and benefits and an incremental \$40 million in spending to fund Grainger's growth and infrastructure investments.

Operating earnings for the third quarter of 2013 were \$347 million, an increase of 36% compared to the third quarter of 2012. Excluding the \$76 million of reserves in the third quarter of 2012, operating earnings increased 5%. The increase in operating earnings was primarily driven by higher sales and improved gross profit margins.

W.W. Grainger, Inc. and Subsidiaries

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL
CONDITION AND RESULTS OF OPERATIONS

Net earnings attributed to W.W. Grainger, Inc. for the third quarter of 2013 increased by 36% to \$211 million from \$155 million in the third quarter of 2012. Diluted earnings per share of \$2.95 in the third quarter of 2013 were 37% higher than the \$2.15 for the third quarter of 2012. The previously mentioned \$76 million of reserves had a \$0.66 earnings per share impact on the third quarter of 2012. Excluding this impact, earnings per share increased 5% versus 2012, due to higher earnings and lower average shares outstanding.

Segment Analysis

Grainger's two reportable segments are the United States and Canada. The United States segment reflects the results of Grainger's U.S. operating segment. The Canada segment reflects the results for Acklands – Grainger Inc., Grainger's Canadian operating segment. Other businesses include operations in Europe, Asia, Latin America and other U.S. operations, which are not material individually.

The following comments at the segment and business unit level include external and intersegment net sales and operating earnings. See Note 8 to the Condensed Consolidated Financial Statements.

United States

Net sales were \$1,905 million for the third quarter of 2013, an increase of \$128 million, or 7%, when compared with net sales of \$1,777 million for the same period in 2012. On a daily basis, sales increased 6%. The 6% daily increase for the quarter consisted of the following:

| | Percent Increase |
|-----------------------|------------------|
| Volume | 5 |
| Business acquisitions | 1 |
| Total | 6% |

The increase in net sales was led by high single digit growth to light manufacturing customers, followed by mid-single digit growth to heavy manufacturing, commercial service and natural resource customers. Government, contractor and retail customers were up in the low single digits and net sales to resellers were down in the low single digits.

The gross profit margin for the third quarter of 2013 decreased 0.3 percentage point compared to the same period in 2012, primarily driven by negative product and customer mix due to strong sales to large customers, which carry lower margins.

Operating expenses were down 8% in the third quarter of 2013 versus the third quarter of 2012. Operating expenses in the third quarter of 2012 included \$76 million of reserves related to the resolution of government contract issues. Excluding these expenses, operating expenses increased 7% driven by an incremental \$36 million in growth and infrastructure spending on areas such as eCommerce, sales force expansion and inventory management solutions.

Operating earnings of \$342 million for the third quarter of 2013 increased 39% from \$247 million for the third quarter of 2012. Excluding the \$76 million of reserves recorded in the third quarter of 2012, operating earnings increased 6%, driven by higher sales and positive operating expense leverage.

Canada

Net sales were \$271 million for the third quarter of 2013, a decrease of \$2 million, or 1%, when compared with \$273 million for the same period in 2012. On a daily basis, sales decreased 2% (increased 2% in local currency). The 2% daily decrease for the quarter consisted of the following:

| | Percent Increase/(Decrease) |
|--|--------------------------------|
|--|--------------------------------|

| | |
|------------------|------|
| Volume | 2 |
| Foreign Exchange | (4) |
| Total | (2)% |

Sales performance in Canada was driven by double digit growth in the oil and gas end market, followed by high single digit growth to forestry, light manufacturing and utilities customers. Sales to heavy manufacturing, construction and retail end markets were down in the mid-single digits.

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W.W. Grainger, Inc. and Subsidiaries

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL
CONDITION AND RESULTS OF OPERATIONS

The gross profit margin increased 0.4 percentage point in the third quarter of 2013 versus the third quarter of 2012, due to cost savings from freight consolidation and higher supplier rebates.

Operating expenses were up 4% in the third quarter of 2013 versus the third quarter of 2012. In local currency, operating expenses increased 8%, primarily due to incremental spending related to a new information technology (IT) system scheduled for implementation in late 2014 and higher volume-related payroll expenses, partially offset by lower bonus expense.

Operating earnings of \$32 million for the third quarter of 2013 were down \$2 million, or 7%, over the third quarter of 2012. In local currency, operating earnings decreased by 3%, driven primarily by incremental spending relating to the new IT system.

Other Businesses

Net sales for other businesses, which include operations in Europe, Asia, Latin America and other U.S. operations, were \$258 million for the third quarter of 2013, an increase of \$3 million, or 1%, when compared with net sales of \$255 million for the same period in 2012. On a daily basis, sales were flat. The drivers of net sales for the quarter consisted of the following:

| | Percent Increase/(Decrease) |
|------------------|--------------------------------|
| Volume/Price | 7 |
| Foreign exchange | (7) |
| Total | 0% |

Operating earnings were \$6 million in the third quarter of 2013, compared to \$9 million in the third quarter of 2012. The earnings decline for the quarter versus prior year was primarily driven by weaker performance in Mexico, Colombia and Brazil, partially offset by improved earnings from Zoro Tools.

Income Taxes

Grainger's effective income tax rates were 38.0% and 37.1% for the three months ended September 30, 2013 and 2012, respectively. The increase was primarily due to lower earnings in foreign jurisdictions with lower tax rates.

W.W. Grainger, Inc. and Subsidiaries

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL
CONDITION AND RESULTS OF OPERATIONS

Matters Affecting Comparability

There were 191 sales days in the nine months of 2013 and 2012. Grainger completed several acquisitions in 2013 and 2012, all of which were immaterial individually and in the aggregate. Grainger's operating results have typically included the results of each business acquired since the respective acquisition dates, however, E&R Industrial's operating results will not be included until the fourth quarter of 2013 due to the timing of the acquisition.

Results of Operations – Nine Months Ended September 30, 2013

The following table is included as an aid to understanding the changes in Grainger's Condensed Consolidated Statements of Earnings:

| | Nine Months Ended September 30, 2013 | | | |
|--|--------------------------------------|---------|---------------------|---|
| | As a Percent of Net Sales | | Percent | |
| | 2013 | 2012 | Increase/(Decrease) | |
| Net sales | 100.0 | % 100.0 | % 5.0 | % |
| Cost of merchandise sold | 55.7 | 56.2 | 4.1 | |
| Gross profit | 44.3 | 43.8 | 6.2 | |
| Operating expenses | 29.6 | 30.8 | 0.8 | |
| Operating earnings | 14.7 | 13.0 | 19.2 | |
| Other income (expense) | (0.1) |) (0.2) |) (22.2) |) |
| Income taxes | 5.4 | 4.8 | 19.0 | |
| Noncontrolling interest | 0.1 | 0.1 | 19.6 | |
| Net earnings attributable to W.W. Grainger, Inc. | 9.1 | % 7.9 | % 20.0 | % |

Grainger's net sales of \$7,061 million for the nine months of 2013 increased 5% compared with sales of \$6,724 million for the comparable 2012 period. The 5% increase for the period consisted of the following:

| | Percent |
|-----------------------|---------------------|
| | Increase/(Decrease) |
| Volume | 4 |
| Price | 1 |
| Business acquisitions | 1 |
| Foreign exchange | (1) |
| Total | 5% |

Sales to all customer end markets, except resellers, increased in the nine months of 2013. The increase in net sales was led by growth in sales to light manufacturing customers, followed by contractors, heavy manufacturing and diversified commercial service customers. Refer to the Segment Analysis below for further details.

Gross profit of \$3,130 million for the nine months of 2013 increased 6%. The gross profit margin during the nine months of 2013 increased 0.5 percentage point when compared to the same period in 2012, primarily driven by price increases exceeding product cost increases, cost savings from freight consolidation and higher supplier rebates, partially offset by unfavorable customer mix from stronger sales to large customers, which carry lower margins.

Operating expenses of \$2,090 million for the nine months of 2013 increased 1%. Operating expenses for 2012 included \$76 million of reserves related to the resolution of government contract issues. Excluding these expenses, operating expenses increased 5% primarily driven by an incremental \$99 million in spending to fund Grainger's growth and infrastructure investments on areas such as eCommerce, sales force expansion, advertising and inventory management solutions.

Operating earnings for the nine months of 2013 were \$1,040 million, an increase of 19% compared to the nine months of 2012. Excluding the \$76 million of reserves recorded in 2012, operating earnings increased 10%. The increase in operating earnings was primarily due to higher sales, improved gross profit margins and positive operating expense leverage.

W.W. Grainger, Inc. and Subsidiaries

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL
CONDITION AND RESULTS OF OPERATIONS

Net earnings attributed to W.W. Grainger, Inc. for the nine months of 2013 increased by 20% to \$640 million from \$534 million in the nine months of 2012. Diluted earnings per share of \$8.92 in the nine months of 2013 were 21% higher than the \$7.35 for the nine months of 2012. The previously mentioned \$76 million of reserves had a \$0.66 earnings per share impact on the nine months of 2012. Excluding this impact, earnings per share increased 11% versus 2012, due to higher earnings and lower average shares outstanding.

Segment Analysis

Grainger's two reportable segments are the United States and Canada. The United States segment reflects the results of Grainger's U.S. operating segment. The Canada segment reflects the results for Acklands – Grainger Inc., Grainger's Canadian operating segment. Other businesses include operations in Europe, Asia, Latin America and other U.S. operations, which are not material individually.

The following comments at the segment and business unit level include external and intersegment net sales and operating earnings. See Note 8 to the Condensed Consolidated Financial Statements.

United States

Net sales were \$5,542 million for the nine months of 2013, an increase of \$323 million, or 6%, when compared with net sales of \$5,220 million for the same period in 2012. The 6% increase for the period consisted of the following:

| | Percent Increase |
|-----------------------|------------------|
| Volume | 3 |
| Price | 2 |
| Business acquisitions | 1 |
| Total | 6% |

Sales to all customer end markets, except resellers, increased in the nine months of 2013. The increase in net sales was led by high single digit growth to light manufacturing customers, followed by mid-single digit growth to heavy manufacturing, diversified commercial services and contractor end markets. Sales to the resellers segment were down in the low single digits.

The gross profit margin increased 0.2 percentage point in the nine months of 2013 over the comparable period of 2012, primarily driven by price increases exceeding product cost increases, partially offset by unfavorable customer mix from stronger sales to large customers, which carry lower margins.

Operating expenses were flat in the nine months of 2013 versus the nine months of 2012. Operating expenses in 2012 included \$76 million of reserves related to the resolution of government contract issues. Excluding these expenses, operating expenses increased 5% driven by an incremental \$90 million on growth and infrastructure spending primarily related to eCommerce, sales force expansion and inventory management solutions.

Operating earnings of \$1,012 million for the nine months of 2013 increased 18% from \$857 million for the nine months of 2012. Excluding the \$76 million of reserves recorded in 2012, operating earnings increased 9% due to higher sales, improved gross profit margins and positive operating expense leverage.

Canada

Net sales were \$842 million for the nine months of 2013, an increase of \$17 million, or 2%, when compared with \$825 million for the same period in 2012. The 2% increase (4% increase in local currency) for the period consisted of the following:

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| | Percent Increase/(Decrease) |
|------------------|--------------------------------|
| Volume | 4 |
| Foreign exchange | (2) |
| Total | 2% |

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W.W. Grainger, Inc. and Subsidiaries

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL
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The increase in net sales was led by double digit growth in the forestry end market, followed by high single digit growth to contractors, oil and gas and light manufacturing customers. The heavy manufacturing and government segments were down in the low single digits.

The gross profit margin increased 0.6 percentage point in the nine months of 2013 versus the nine months of 2012, primarily driven by cost savings from freight consolidation, higher supplier rebates and stronger sales of private label products.

Operating expenses were up 3% in the nine months of 2013 versus the nine months of 2012. In local currency, operating expenses increased 5%, primarily due to higher volume-related payroll, professional services and incremental spending related to a new IT system, partially offset by lower bad debt expense.

Operating earnings of \$102 million for the nine months of 2013 were up \$4 million, or 5%, over the nine months of 2012. In local currency, operating earnings increased 7% in the nine months of 2013 over the same period in 2012. The increase in earnings was due to sales growth and improved gross profit margins.

Other Businesses

Net sales for other businesses, which include operations in Europe, Asia, Latin America and other U.S. operations, were \$768 million for the nine months of 2013, an increase of \$25 million, or 3%, when compared with \$743 million for the same period in 2012. The sales increase was primarily due to incremental sales from Zoro Tools, Brazil and Mexico, partially offset by lower sales in India due to a change in its business model. The 3% increase for the period consisted of the following:

| | Percent Increase/(Decrease) |
|------------------|--------------------------------|
| Volume/Price | 9 |
| Foreign exchange | (6) |
| Total | 3% |

Operating earnings were \$27 million in the nine months of 2013, compared to \$31 million in the nine months of 2012. The earnings decline for the period versus prior year was primarily driven by weaker performance in Mexico, Brazil and Colombia, partially offset by improved earnings from Zoro Tools and Japan.

Income Taxes

Grainger's effective income tax rates were 37.3% and 37.5% for the nine months ended September 30, 2013 and 2012, respectively. The 2013 tax rate includes a benefit from the resolution of foreign tax matters in the second quarter. Grainger is currently projecting an effective tax rate of 37.4% to 37.8% for the full year.

W.W. Grainger, Inc. and Subsidiaries

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL
CONDITION AND RESULTS OF OPERATIONS

Financial Condition

Cash Flow

Cash from operating activities continues to serve as Grainger's primary source of liquidity. Net cash provided by operating activities was \$740 million and \$576 million for the nine months ended September 30, 2013 and 2012, respectively. The primary contribution to cash flows from operating activities was net earnings of \$648 million in the nine months ended September 30, 2013 compared to \$540 million in the nine months of 2012. In addition, changes in operating assets and liabilities resulted in a net use of cash of \$69 million in the nine months of 2013 compared to \$117 million in the nine months of 2012. The lower use of cash for operating assets and liabilities was driven primarily by timing on accounts payable and lower inventory purchases for the nine months of 2013 compared to the nine months of 2012. Inventory purchases were down for the nine months of 2013 due to a higher inventory balance at the beginning of the year as a result of lower sales in December of 2012 and an inventory build at the end of 2012 to facilitate the move of Grainger's Chicago-area distribution center.

Net cash used in investing activities was \$273 million and \$174 million for the nine months ended September 30, 2013 and 2012, respectively. Cash paid for business acquisitions of \$128 million was primarily driven by the acquisition of E&R Industrial in the third quarter of 2013 and the purchase of the remaining interest of the business in Colombia in the second quarter of 2013. Cash expended for additions to property, buildings, equipment and capitalized software was \$148 million in the nine months ended September 30, 2013, compared to \$155 million in 2012.

Net cash used in financing activities was \$368 million and \$322 million for the nine months ended September 30, 2013 and 2012, respectively. The \$46 million increase in cash used in financing activities for the nine months ended September 30, 2013 was due to an increase in dividends paid and a net decrease in long-term debt.

Working Capital

Working capital consists of current assets (less non-operating cash) and current liabilities (less short-term debt and current maturities of long-term debt).

Working capital at September 30, 2013, was \$1,668 million, an increase of \$64 million when compared to \$1,604 million at December 31, 2012. The working capital assets to working capital liabilities ratio increased to 2.7 at September 30, 2013, from 2.6 at December 31, 2012. The increase primarily related to higher receivable balances and lower profit sharing accruals due to the timing of annual payments.

Debt

Grainger maintains a debt ratio and liquidity position that provide flexibility in funding working capital needs and long-term cash requirements. In addition to internally generated funds, Grainger has various sources of financing available, including bank borrowings under lines of credit. Total debt as a percent of total capitalization was 14.0% at September 30, 2013, and 15.3% at December 31, 2012.

W.W. Grainger, Inc. and Subsidiaries

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL
CONDITION AND RESULTS OF OPERATIONS

Critical Accounting Policies and Estimates

The preparation of financial statements, in conformity with accounting principles generally accepted in the United States of America, requires management to make judgments, estimates and assumptions that affect the reported amounts of assets, liabilities, revenues and expenses in the financial statements. Management bases its estimates on historical experience and other assumptions, which it believes are reasonable. If actual amounts are ultimately different from these estimates, the revisions are included in Grainger's results of operations for the period in which the actual amounts become known.

Accounting policies are considered critical when they require management to make assumptions about matters that are highly uncertain at the time the estimates are made and when there are different estimates that management reasonably could have made, which would have a material impact on the presentation of Grainger's financial condition, changes in financial condition or results of operations. For a description of Grainger's critical accounting policies see Grainger's Annual Report on Form 10-K for the year ended December 31, 2012.

Forward-Looking Statements

This Form 10-Q contains statements that are not historical in nature but concern future results and business plans, strategies and objectives and other matters that may be deemed to be "forward-looking statements" under the federal securities laws. Grainger has generally identified such forward-looking statements by using words such as "anticipated, believes, continues, could, earnings per share guidance, estimate, estimated, expected, expecting, forecasted, guidance, intended, intends, historically correlated, may, not expected, possible, projected, projecting, projections, proposed, provide, range, reasonably likely, sales growth guidance, scheduled, should, subject to, tend, tended, tend to correlate, tend to shape, trends, unanticipated, uncertainties, will, will remain" or similar expressions.

Grainger cannot guarantee that any forward-looking statement will be realized although Grainger does believe that its assumptions underlying its forward-looking statements are reasonable. Achievement of future results is subject to risks and uncertainties which could cause Grainger's results to differ materially from those which are presented.

Factors that could cause actual results to differ materially from those presented or implied in a forward-looking statement include, without limitation: higher product costs or other expenses; a major loss of customers; loss or disruption of source of supply; increased competitive pricing pressures; failure to develop or implement new technologies or business strategies; the outcome of pending and future litigation or governmental or regulatory proceedings; investigations, inquiries, audits and changes in laws and regulations; disruption of information technology or data security systems; general industry or market conditions; general global economic conditions; currency exchange rate fluctuations; market volatility; commodity price volatility; labor shortages; facilities disruptions or shutdowns; higher fuel costs or disruptions in transportation services; natural and other catastrophes and unanticipated weather conditions.

Caution should be taken not to place undue reliance on Grainger's forward-looking statements and Grainger undertakes no obligation to publicly update the forward-looking statements, whether as a result of new information, future events or otherwise.

W.W. Grainger, Inc. and Subsidiaries

Item 3. Quantitative and Qualitative Disclosures About Market Risk

For quantitative and qualitative disclosures about market risk, see “Item 7A: Quantitative and Qualitative Disclosures About Market Risk” in Grainger's Annual Report on Form 10-K for the fiscal year ended December 31, 2012.

Item 4. Controls and Procedures

Disclosure Controls and Procedures

Grainger carried out an evaluation, under the supervision and with the participation of its management, including the Chief Executive Officer and the Chief Financial Officer, of the effectiveness of the design and operation of Grainger's disclosure controls and procedures pursuant to Exchange Act Rule 13a-15. Based upon that evaluation, the Chief Executive Officer and the Chief Financial Officer concluded that Grainger's disclosure controls and procedures were effective as of the end of the period covered by this report.

Changes in Internal Control Over Financial Reporting

There were no changes in Grainger's internal control over financial reporting that occurred during the third quarter that have materially affected, or are reasonably likely to materially affect, Grainger's internal control over financial reporting.

PART II – OTHER INFORMATION

Items 1A, 3, 4 and 5 not applicable.

Item 1. Legal Proceedings

Information on specific and significant legal proceedings is set forth in Note 10 to the Condensed Consolidated Financial Statements included under Item 1.

W.W. Grainger, Inc. and Subsidiaries

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds

Issuer Purchases of Equity Securities – Third Quarter

| Period | Total Number of Shares Purchased (A) | Average Price Paid per Share (B) | Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs (C) | Maximum Number of Shares That May Yet be Purchased Under the Plans or Programs |
|------------------|--------------------------------------|----------------------------------|--|--|
| July 1 – July 31 | 67,459 | \$257.49 | 67,459 | 4,460,244 shares |
| Aug. 1 – Aug. 31 | 207,596 | \$254.86 | 207,596 | 4,252,648 shares |
| Sep. 1 – Sep. 30 | 25,238 | \$256.50 | 25,238 | 4,227,410 shares |
| Total | 300,293 | \$255.59 | 300,293 | |

- (A) There were no shares withheld to satisfy tax withholding obligations in connection with the vesting of employee restricted stock awards.
- (B) Average price paid per share includes any commissions paid and includes only those amounts related to purchases as part of publicly announced plans or programs.
- (C) Purchases were made pursuant to a share repurchase program approved by Grainger's Board of Directors on July 28, 2010. The program has no specified expiration date. Activity is reported on a trade date basis.

Item 6. Exhibits

- (a) Exhibits (numbered in accordance with Item 601 of Regulation S-K)
- (31) Rule 13a – 14(a)/15d – 14(a) Certifications
- (a) Chief Executive Officer certification pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
- (b) Chief Financial Officer certification pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
- (32) Section 1350 Certifications
- Certifications pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
- 101.INS XBRL Instance Document.
- 101.SCH XBRL Taxonomy Extension Schema Document.
- 101.CAL XBRL Taxonomy Extension Calculation Linkbase Document.
- 101.DEF XBRL Taxonomy Extension Definition Linkbase Document.
- 101.LAB XBRL Taxonomy Extension Label Linkbase Document.
- 101.PRE XBRL Taxonomy Extension Presentation Linkbase Document.

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

W.W. Grainger, Inc.
(Registrant)

Date: October 31, 2013

By: /s/ R. L. Jadin
R. L. Jadin, Senior Vice President
and Chief Financial Officer

Date: October 31, 2013

By: /s/ G. S. Irving
G. S. Irving, Vice President
and Controller